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18 May 1984

MEMORANDUM FOR: Deputy Director for Intelligence

FROM: Douglas J. MacEachin
Director of Soviet Analysis

SUBJECT: Critique of a Wall Street Journal Editorial
on "Subsidizing the Soviets" (U)

1. The Wall Street Journal article of 14 May (attached) cited above makes the following points about the Soviet hard currency debt:

- a. In a joint report, the Organization for Economic Cooperation and Development (OECD) in Paris and the Bank for International Settlements (BIS) in Basel revealed that the Soviets owed the West as of end-June 1983 more than \$28.8 billion.
- b. This amount was twice as high as previous estimates, which did not combine private and government loans.
- c. The USSR ranked first in the world in loans subsidized by Western governments, a total of \$17.67 billion. (U)

2. The statement that the OECD/BIS estimate of the Soviet end-June 1983 debt to the West of \$28.8 billion is "twice as much as previous estimates" refers to debt numbers published in various open sources and covering only that part of the debt reported by the BIS (i.e., the \$14.5 billion Soviet and CEMA bank liabilities to Western commercial banks at end-June 1983). Of this, we estimate that roughly \$4.5 billion consisted of the liabilities of the two CEMA banks. Our estimate of total Soviet hard currency debt--which includes Western government and government backed debt as well as liabilities to Western commercial banks--is \$20.8 billion at end-June 1983. If the CEMA banks are included the debt rises to roughly \$25 billion. (C)

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3. Our estimates of total Soviet debt differ from the OECD/BIS data even more in the structure--Western government versus private bank credits--than in the total. We estimate the Soviet debt on Western government supported credits at \$9.1 billion at end-June, substantially lower than the OECD/BIS estimate of \$17.7 billion. Conversely, we estimate that portion of Soviet and CEMA bank debt which consists of liabilities on private commercial bank credits and deposits at about \$16 billion, considerably higher than the OECD/BIS estimate of \$11.1 billion. We believe, that much of the difference in the estimates arises from double counting by the OECD/BIS and from their failure to discount enough for undisbursed credits and interest payments included in the raw OECD data on Soviet debt on Western government and government-backed credits. We cannot demonstrate this, however, without a better understanding of the OECD/BIS methodology. (C)

4. The OECD/BIS exposition of their methodology is not specific enough to allow us to duplicate their estimates. Some of the sweeping generalizations made, however, lead us to suspect the whole methodology. For example, in discounting for undisbursed amounts in total debt on Western government-backed credits reported by individual creditors, OECD/BIS assumes that for borrowers faced with foreign exchange shortages all credits--except those for large, ongoing projects--reported as outstanding would have been disbursed in full. We disagree. Our evidence indicates that there are generally one to three year lags between the negotiation of the credits and their disbursement. This coincides with lags in delivery of equipment purchased with the credit. It is unlikely that the lenders would permit drawdowns of the credits prior to delivery of the goods. Moreover, the OECD/BIS methodology claims that double counting in the pooled OECD and BIS data is of marginal significance and that in any case any double counting is offset at least to some extent by undercounting of the debt because of gaps in information. It goes on to claim that the maximum possible error is on the order of 2 percent of the total estimated debt. These assertions are not backed up in any way. Moreover, the OECD/BIS assumptions apparently are applied across the board to all of the countries for which OECD/BIS estimates are made. (C)

5. The statement that the USSR owes a total of \$17.67 billion in loans subsidized by Western governments is completely off base. The number cited is for total Soviet debt on Western government and government-backed credits and it is unlikely that more than a very small portion of these carry subsidized interest rates. Even in some of the cases where Western exporters have offered lower than market rates to the USSR, the difference has reportedly been made up through higher prices for the exported

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commodity. Moreover, as indicated above, our estimate of Soviet debt on Western government-backed credits was about \$9 billion, much less than the OECD/BIS figure. Regardless of the specific numbers, the USSR is today in a comfortable financial position. The Soviet debt service ratio is less than 20 percent and, based on other economic criteria, such as liquidity and past payments record, Western bankers rate their creditworthiness fairly high. (C)

DOUGLAS J. MacEACHIN

Attachment:
as stated

OPERATIONS CENTER/CURRENT SUPPORT GROUP

DDI/SDA

News Bulletin : THE WALL STREET JOURNAL, Pg. 26

14 May 1984
Item No. 3

REVIEW & OUTLOOK

Subsidizing the Soviets

A group of West European banks last week brushed aside all memories of sick Polish loans and cheerfully had another go at the roulette wheel with a new \$250 million loan to the Soviet Union. The Eurobanks would have happily forked over \$300 million had not the Russians said, "Oh no, please, that's too much." We're happy to report that American banks chose not to play, proving that they have learned a few things.

The latest European plunge eastward coincided with some other news. In a joint report, the Organization for Economic Cooperation and Development (OECD) in Paris and the Bank for International Settlements (BIS) in

The figures in the table are not all-inclusive. IMF loans are excluded. And East German debt figures are incomplete because the West Germans describe some of it as "intra-German" lending, conveniently ignoring the well-known no man's land that separates the two Germanies. In short, the total West-to-East subsidy is underestimated.

The Soviet subsidy loan level, never before acknowledged by the lending countries, raises an interesting question for Europe's political and business leaders: When did taxpayers in the lending countries ever decide to subsidize communism?

Two reasons can be offered for the Western generosity to the Soviets. As someone once noted, the Russians are like the Pentagon. They don't trade, they procure, and in huge amounts. Western businessmen and politicians simply can't resist those big deals. Since taxpayers aren't readily aware that they are providing the subsidies, who worries? The second reason is that Western politicians mistakenly believe that credit generosity is a way of appeasing Soviet warlords.

President Reagan, pressing his disfavor over the Siberian pipeline deal, has tried to lift OECD standards for loans to the Soviets. But European banks, businesses and politicians still are answering the siren call. They choose not to trouble themselves with the important fact that the Soviet Union, as an economic cripple, has little to trade in return, except the privilege of becoming dependent on Soviet energy. That fact has economic importance. One-sided trading is a sure route for the Soviets to the debt-restructuring line, and when they request the favor, the Europeans are not likely to refuse. At that point, the transfer of resources from West Europe to the Soviet people will grow even larger.

American bankers last week decided that it was time to draw a line. We wonder how much more the Europeans will want to contribute to the Soviet empire before they reach the same conclusion.

Basel revealed that the Soviets already owed the West more than \$28.7 billion, as of last June. That is twice as much as previous estimates, which did not combine private and government loans. And it almost certainly understates the total current Soviet hard-currency debt, which by all accounts is up from last June. Banking circles also believe that Moscow Narodny Bank's West European branches have a large net borrower position in the short-term "interbank" market.

But even without further growth, the \$28.7 billion made the Soviet Union the third-largest hard-currency debtor in the world, behind Brazil and Mexico. More startlingly (see table), it ranked *first* in the world in loans subsidized by Western governments, a total of \$17.67 billion.

Of the \$17.67 billion, \$5.8 billion is bank loans guaranteed or insured by governments and \$11.8 billion is direct credits backed by governments to Western exporters of goods "sold" to the Soviets. Those quotation marks symbolize the hocus-pocus of East-West trade. When loans to Brazil, Argentina and the like go sour, private bankers are at least forced to lose a little sleep until the IMF or central banks bail them out. But in lending to the communists, their bailout is up

front in the form of guarantees. No wonder they can be so cheerful.